

Internal Revenue Service

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Person To Contact:

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Date:

June 15, 2007

Legend:

Fund =

Advisor =

Company =

Subsidiary =

Country =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Date 10 =

X =

Y =

Dear :

This responds to your request dated December 18, 2006, and supplemental correspondence dated May 23, 2007, requesting certain rulings on behalf of Fund. The requested rulings concern (1) whether the receipt of payment by Fund from Advisor will constitute qualifying income under section 851(b)(2) of the Internal Revenue Code (the "Code"), and (2) whether Fund will have satisfied the diversification test under 851(b)(3) upon receipt of a note from Advisor.

FACTS

Fund has made an election to be taxed as a regulated investment company (RIC) under Subchapter M, part 1 of the Code. Fund uses a calendar year for federal income tax purposes.

Fund invested in a Country corporation which was taxable for U.S. federal income tax purposes as a passive foreign investment company (the "PFIC"). The PFIC invested in one or more segregated portfolio companies (SPCs) organized under Country law, each of which were taxable as partnerships for U.S. federal income tax purposes. The SPCs held deposits as collateral for its trading activities with Subsidiary, a subsidiary of Company. Subsidiary operated as a private bank.

On or about Date 1, the advisor to the PFIC and the SPCs requested a return of its invested money from Subsidiary. After the Subsidiary transferred the money Company froze all customer accounts at Subsidiary, thereby preventing any persons from receiving invested money. On Date 2, Company and Subsidiary filed voluntary petitions for reorganization relief under Chapter 11 of the Bankruptcy Code in the U.S. Bankruptcy Court. On or about Date 3, the bankruptcy court ordered the amounts Subsidiary paid to certain investors be frozen as a possible preference item in the bankruptcy of Company.

Fund's investment in PFIC constituted approximately X% of Fund's total assets. Fund made two tenders for redemption of its PFIC shares, one on Date 4, and another on Date 5. In the redemption Fund received cash and shares (the "Shares") which Fund believes are shares in the SPCs in which the PFIC invested. The Shares likely represent the underlying assets in the PFIC which are subject to an attachment order in the preference action. Subsequently, Fund determined that as a result of the Company bankruptcy the Shares had depreciated approximately between 8 and 30 percent of the

tender fair market value. In addition, PFIC's advisor indicated that the Shares were not transferable.

On Date 6, Fund's Board of Trustees held a special meeting pursuant to a proxy of Fund's shareholders to offer the shareholders the opportunity to receive either cash for their interests or to become owners in a different fund advised by Advisor. Whether a shareholder chose the cash option or the investment in the new fund, X percent of the proceeds would be held back pending the resolution of the Company bankruptcy.

To maintain goodwill and its reputation, Advisor paid to Fund an amount that would have been paid to Fund on the earlier two tender dates. Accordingly, on Date 7 Advisor transferred to Fund an amount in cash and a note (the "Note") totaling Y in connection with a settlement agreement (the "Settlement Agreement") with Fund, whereby Fund agreed to release Advisor from any liability it may have involving the investment in the PFICs. As part of the Settlement Agreement, Fund also agreed that it will pay Advisor any amounts Fund ultimately received on account of its ownership of the Shares.

The Note was payable by Date 8 and was satisfied in full one day earlier on Date 9. Fund liquidated on Date 9 by distributing the Shares to a liquidating trust.

Fund makes the following representation:

1. The transactions were not entered into to artificially inflate Fund's qualifying income for purposes of section 851(b) of the Code.
2. At the close of its quarter ending Date 10, Fund otherwise satisfied the diversification test under Section 851(b)(3) if the value of the Note was treated as cash held by Fund for purposes of 851(b)(3) of the Code.

LAW AND ANALYSIS

Section 851(b)(2) of the Code requires that for a corporation to be taxed as a RIC, at least 90 percent of the corporation's gross income must be from certain sources, including dividends, interests, gains from the sale or other disposition of stock or securities or foreign currencies, or other income (including but not limited to gains from options, futures or forward contracts) derived with respect to its business of investing in such stock, securities, or currencies. For purposes of this test, the term securities is defined in section 2(a)(36) of the 1940 Act.

In Rev. Rul. 74-248, 1974-1 C.B. 167, a RIC received a specified amount in settlement of litigation against its former investment advisor. The litigation alleged that the former investment advisor received compensation in connection with the merger of the RIC and the appointment of a new investment advisor. Rev. Rul. 74-248 holds that

the amount received by the RIC is included in gross income, and that the inclusion of this amount will not cause the RIC to fail to meet the definition of a RIC contained in section 851 of the Code. Similarly, Rev. Rul. 64-247, 1964-2 C.B. 179, holds that amounts recovered in a suit against former officers and directors of a fund do not cause a RIC to fail to meet the definition of a RIC contained in section 851.

In 1986, section 851(b)(2) of the Code was amended to specify that qualifying income includes other income derived by a RIC with respect to its business of investing in stocks, securities, or foreign currencies. Section 653(b) of the Tax Reform Act of 1986, 1986-3 (vol. 1) C.B. 215.

Rev. Rul. 92-56, 1992-2 C.B. 153, again examined the issue of qualifying income of a RIC. This revenue ruling holds that if, in the normal course of its business, a RIC receives a reimbursement from its investment advisor and the reimbursement is includible in the RIC's gross income, the reimbursement is qualifying income under section 851(b)(2) of the Code. Rev. Rul. 92-56 also indicates, based on the 1986 amendments to section 851(b)(1), that Rev. Rul. 64-247 and Rev. Rul. 74-248 are obsolete to the extent they imply that the payments in those factual situations would not be qualifying income under section 851(b)(2).

Fund received the cash payment and Note from Advisor in the normal course of its business of investing in the stock, securities or foreign currencies. Accordingly, the receipt of payment by Fund is a reimbursement that is qualifying income under section 851(b)(2) of the Code.

In addition, Section 851(b)(3) of the Code provides that a corporation shall not be considered a RIC for any taxable year unless, at the close of each quarter of the taxable year, (A) at least 50 percent of the value of its total assets is represented by cash, cash items, Government securities, securities of other RICs, and other securities (limited, in the case of other securities of any one issuer, to not more than 5% of the value of the assets of the RIC and to not more than 10 percent of the voting securities of the issuer); and (B) not more than 25% of the value of the RIC's total assets is invested in (i) securities (other than Government securities or the securities of other RICs) of any one issuer, (ii) the securities (other than the securities of other RICs) of 2 or more issuers which the RIC controls and which are engaged in the same, similar, or related trades or businesses, or (iii) the securities of one or more qualified publicly traded partnerships.

The diversification requirements of section 851 of the Code are designed to prevent RICs from concentrating their investment assets in a small number of companies or in certain forms of assets. Rev. Rul. 76-392, 1976-2 C.B. 249. Section 851(d) provides in pertinent part that a corporation which meets the requirements of section 851(b)(3) at the close of any quarter shall not lose its status as a RIC because of a discrepancy during a subsequent quarter between the value of its various investments and such requirements unless the discrepancy exists immediately after the

acquisition of any security or other property and is wholly or partly the result of this acquisition. A corporation which does not meet such requirements at the close of any quarter by reason of a discrepancy existing immediately after the acquisition of any security or other property which is wholly or partly the result of such acquisition during such quarter shall not lose its status for such quarter as a regulated investment company if such discrepancy is eliminated within 30 days after the close of such quarter and in such cases it shall be considered to have met such requirements at the close of such quarter for purposes of applying the preceding sentence.

Upon receipt of the Note on Date 7, Fund represents that its assets did not meet the requirements of the asset diversification test under section 851(b)(3) of the Code and further represents that on Date 10 Fund failed to meet these requirements at the close of the quarter. Fund availed itself of the cure provision in section 851(d) by disposing of the Note within 30 days of the close of the quarter. Therefore, if Fund otherwise satisfied the requirements of section 851(b)(3), Fund shall be considered to have met the requirements of section 851(b)(3) at the close of the quarter ending on Date 10.

CONCLUSION

We rule that the Fund's receipt of the Note and a cash payment from Advisor in connection with the Settlement Agreement described in this letter is qualifying income under section 851(b)(2) of the Code as other income derived with respect to Fund's business of investing in stocks, securities, or currencies. We further rule that the satisfaction of the Note for cash within the 30-day period following Date 10 eliminates any discrepancy between the value of Fund's investments and the requirements of section 851(b)(3) at the close of the quarter ending on Date 10.

No opinion is expressed as to whether Fund qualifies as a RIC that is taxable under subchapter M, part I of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Susan Thompson Baker
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Assistant to the Branch Chief, Branch 2
Office of the Associate Chief Counsel
(Financial Institutions & Products)